Rating Corporate Governance of State-Owned Enterprises

Moving towards improved performance
CONTENTS

Executive summary ........................................................................................................... 1
Introduction ......................................................................................................................... 4
Background ......................................................................................................................... 5
A Matrix for state-owned enterprises ............................................................................... 6
The SOE Matrix categories and indicators ..................................................................... 7
Board and committee composition .................................................................................. 7
Accountability ................................................................................................................... 7
Remuneration .................................................................................................................... 8
Functioning of the board ................................................................................................. 8
Reporting ........................................................................................................................... 8
Stakeholders ....................................................................................................................... 9
Social ................................................................................................................................... 9
Environmental .................................................................................................................. 9
Research sample ............................................................................................................... 10
Project team ....................................................................................................................... 11
Research process .............................................................................................................. 11
Results ................................................................................................................................ 11
Interpretation of results ................................................................................................. 11
Board and committee composition .................................................................................. 12
Accountability ................................................................................................................... 12
Functioning of the board ................................................................................................. 12
Reporting ........................................................................................................................... 12
Schedule 1 SOEs ............................................................................................................... 12
Schedule 2 SOEs ............................................................................................................... 13
Survey response ............................................................................................................... 13
Schedule 1 ......................................................................................................................... 14
Schedule 2 ......................................................................................................................... 14
Comparison with private sector ....................................................................................... 14
Recommendations ............................................................................................................ 15
References ......................................................................................................................... 15
EXECUTIVE SUMMARY

In 2011, following discussions between the Centre for Corporate Governance in Africa at the University of Stellenbosch Business School and the Hanns Seidel Foundation, it was agreed to conduct research on governance in South African state-owned enterprises (SOEs). This agreement was made within the context of existing research conducted by the Centre on behalf of the Public Investment Corporation (PIC).

In 2008, the Centre was commissioned by PIC to develop and apply a Corporate Governance Rating Matrix (the Matrix) for South African corporations. The Matrix was developed with the assistance of a team of experts and applied to the top 40 listed companies on the JSE Ltd. In subsequent years the Matrix was refined and applied to the top 100 listed companies.

With financial support provided by the Hanns Seidel Foundation, the Matrix was adapted to enable measurement of governance in the SOE sector. This adaptation was undertaken by Lynn McGregor, Senior Research Fellow at the Centre, and special advisor Nozizwe Madlala-Routledge, former Deputy Government Minister. Considerable research was done through interviews and conversations with senior officials of various government departments that are responsible for SOEs.

The SOE Matrix consists of 92 indicators divided into the following categories and sub-categories:

- **Board and Committee Composition**
  - Board Composition
  - Board Audit Committee
  - Other Board Committees
- **Accountability**
- **Remuneration**
- **Functioning of the Board**
  - Strategy
  - Sufficiency of Meetings and Evidence of Planning
  - Constructive Involvement of Government
- **Reporting**
  - Reporting and Quality of Reporting
  - Financial Reporting – Unqualified Audit Report
- **Stakeholders**
  - Stakeholder Relationships
  - Reputational Management
- **Social**
  - Evidence of Concrete Support for Governmental Priorities
- **Environmental**

The SOE Matrix is not seen as a final product; it will continue to evolve. However, the project team was satisfied that the end-product reflected all the material issues that had to be measured. It was agreed at a stakeholder workshop that the initial research sample should include Schedule 1 and Schedule 2 organisations as outlined in the tables below.

### Schedule 1: Constitutional institutions

<table>
<thead>
<tr>
<th>1</th>
<th>The Commission for the Promotion and Protection of the Rights of Cultural, Religious and Linguistic Communities</th>
</tr>
</thead>
<tbody>
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<td>The Commission on Gender Equality</td>
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<td>4</td>
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<td>The Public Protector of South Africa</td>
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<td>9</td>
<td>The South African Human Rights Commission</td>
</tr>
</tbody>
</table>
The project team comprised the following individuals:

- **Lynn McGregor (project leader):** Lynn is a senior research fellow at the Centre for Corporate Governance in Africa, an acknowledged corporate governance author and consultant.
- **Anna Yortt (project manager):** Anna is the research manager of the Centre for Corporate Governance in Africa.
- **Daniel Malan (project advisor):** Daniel is the director of the Centre for Corporate Governance in Africa and senior lecturer in Ethics and Governance at the University of Stellenbosch Business School.
- **Nozizwe Madlala-Routledge (project advisor):** Nozizwe, a former deputy minister, has extensive knowledge of government and parliament, and considerable chairmanship, facilitation and organisational experience.
- **Riedwaan Baboo (researcher).**

The research was conducted in two stages:

- **Public research:** The Matrix was applied to Schedule 1 and Schedule 2 SOEs by research analysts based on publicly available information including annual reports, sustainability reports and websites. The long-term intention with the exclusive focus on publicly available information is to encourage disclosure and transparency. Although the expectation was that disclosure levels would be much lower than in the private sector, for comparative purposes the decision was made to restrict the initial stage to publicly available information only.

- **Survey:** An electronic survey was developed and sent to the chief executive officers of the 30 Schedule 1 and Schedule 2 SOEs with a two-week deadline. Phone call and email follow-ups were undertaken in order to ensure that the survey was received. An email reminder was sent out, and follow-up phone calls were made. The deadline was extended by one week to improve the response rate.

Some of the indicators that are not applicable to Schedule 1 entities were removed from the analysis of these entities. As a result of the very low levels of disclosure in this category it was decided not to release the names of the Schedule 1 top performers, since these scores were all below 50%.

**The top 5 Schedule 2 entities were:**
1. DENEL (Pty) Ltd
2. Transnet Ltd
3. Telkom SA Ltd
4. South African Post Office Ltd
5. Development Bank of Southern Africa
It should be emphasised that the SOE Matrix covers a very broad range of governance components that were assessed based on public disclosure. The research did not cover negative media coverage on any individual aspect, and also does not provide assurance on the accuracy of information disclosed in public documents. Therefore, a high score according to the SOE Matrix should not be interpreted as an endorsement of all governance practices of a particular entity. In terms of the current methodology, it is possible for an entity to receive negative media coverage on a particular component (e.g. corruption) while at the same time obtaining a high score as a result of good disclosure against all indicators. As the Matrix was revised to ensure that it is applicable to the public sector the results are not directly comparable with the private sector results. However, specific indicators have been duplicated in both versions of the Matrix. The comparisons drawn here refer to the 20 Schedule 2 major public entities as at 31 December 2010 and the JSE Top 40 as at 30 November 2010.

A statistically significant difference was found for the independence of the chairperson and also the board comprising a majority of independent directors with the private sector performing better in both instances. This can be explained with reference to the method of appointment in the public sector. However, when diversity was assessed the public sector performed better in terms of both black and female board representation. For both board and committee attendance the private sector performed better. For an unmodified audit report the private sector performed better with all of the top 40 having an unmodified audit report.

The research highlights the need to improve the governance structures, mechanisms and processes existing within public entities. Our recommendations are as follows:

In terms of performance, the overall recommendation is that all entities should improve their disclosure. In particular, more information is required on issues such as board committees, sufficiency of meetings and evidence of planning, as well as the position of the company secretary. Without disclosure it is impossible to measure performance accurately, and it is our hope that more detailed disclosure in future will allow shareholders and other stakeholders to perform a more accurate assessment of individual performance areas.

In terms of a future research agenda, we recommend the following:

• Apply and continue to modify the SOE Matrix as part of a joint USB, Hanns Seidel Foundation and (possibly) Government project. We believe that the SOE Matrix should be made available to all SOEs as a template that could be used to measure and report on governance performance. In this regard, we recommend further discussions to be held with members of the former Presidential Review Committee on State-Owned Enterprises and the Public Investment Corporation;
• Continue to rate SOEs and revise the Matrix on an annual basis;
• Expand the number of entities being rated;
• Conduct a survey to ascertain key interventions, training and coaching needed to accelerate the development of SOEs towards best practice;
• Provide Corporate Governance training and coaching for all SOE boards, government departments and senior executives; and
• Set up a formal research and development unit for the assessment and development of governance in SOEs.
INTRODUCTION

South Africa finds itself in the interesting position where it receives international recognition for its high standards of corporate governance while at the same time observers raise serious concerns about corruption and the rule of law. This dichotomy is indicative of a country of contrasts, one that has gone through the miracle of a peaceful transition to democracy while it remains deeply divided at many levels.

Governance lies at the heart of a deeper understanding of how well our country is really doing. Governance – as the classical definition describes succinctly – is the way in which organisations are directed and controlled. It focuses on performance and conformance, and is different from management. This applies to corporations in the realm of corporate governance, and to governments in the realm of public sector governance.

State-owned enterprises straddle the divide between a corporate and public environment, and therefore have their very own dynamics. When assessing the governance of a state-owned enterprise, one cannot simply apply the standard criteria of corporate governance because the reality of state ownership dictates otherwise. However, because state-owned enterprises are enterprises, one cannot merely apply public sector criteria to them either.

We live in a world where boundaries are shifting all the time. Within the private sector there has been an increasing focus on environmental, social and governance (ESG) issues, as opposed to the traditional focus on financial performance only. At the same time, many governments are learning from corporations. This is reflected in attempts to become more professional, business-like and efficient. An example from South Africa is how, some years ago, the South African Revenue Services turned itself around into one of the most efficient state organisations.

For both the public and private sectors the fundamental governance principles are relevant: accountability, honesty and transparency. These are the hallmarks of good governance and good government – it goes to the heart of the original root of the concept – the Greek word "kybernetes" (helmsman or steersman) – helping a ship to reach its destination (performance) without running into troubled waters (conformance).

Once again, SOEs become an interesting laboratory of this crossover between the need for corporate efficiency and social (and political) expediency. The project described in this report – the development of a Governance Matrix for SOEs – was aimed at an initial measurement of how well South African SOEs meet this challenge. It was performed by the Centre for Corporate Governance in Africa (the Centre) at the University of Stellenbosch Business School and outlines how a tool that was developed for the corporate sector was adapted to be relevant for the SOE sector, and how an initial sample of enterprises and institutions were assessed based on these criteria.

Our research has indicated that not only differences between SOEs and the private sector, but also substantial differences within the SOE sector, for example between major public entities and commissions, will have to be taken into account in future. We believe that our research is aligned with a recent governmental review process of SOEs and trust that the results of this project will help SOEs to improve their levels of governance, both in terms of performance and compliance. Looking forward, a considerable amount of research still needs to be conducted to refine the Matrix so that it meets the requirements of Government and other stakeholders to a larger extent.

We would like to acknowledge the financial support of the Hanns Seidel Foundation that made this research possible. We are delighted that the Presidential Review Committee on Governance in State-owned Enterprises took an active interest in the work that we do, and we look forward to expand our research and to work with a larger group of stakeholders in future.
BACKGROUND

In 2008, the Centre was commissioned by the Public Investment Corporation (PIC) to develop and apply a Corporate Governance Rating Matrix (the Matrix) for South African corporations. The Matrix was developed with the assistance of a team of experts and applied to the top 40 listed companies on the JSE Ltd. In subsequent years the Matrix was refined and applied to the top 100 listed companies.

The Matrix is a joint venture between the PIC and the Centre, which jointly own the intellectual property, including the scoring methodology. The main aspirations of the Matrix are to:

- Help shape corporate behaviour;
- Encourage transparency;
- Encourage a paradigm shift to focus on the creation of long-term value and the role of business in society;
- Create a body of knowledge against which to evaluate South African companies.

Ultimately, the Matrix is viewed as a developmental tool, aimed at assisting companies to improve their corporate governance performance and reporting.

The Matrix incorporates existing PIC Governance Principles, South African corporate governance standards and reflects on key debates in terms of international best practice and standards such as the UN Global Compact and the UN Principles for Responsible Investment. It recognises that governance is structural, systemic and relational, and that sound governance practices require a commitment to all stakeholders. It further highlights the interaction between disclosure, compliance and performance, with an emphasis on performance. To encourage transparency there is an explicit focus on disclosure – the Matrix only makes use of publicly available information with the result that no indicator can be scored without public disclosure. The figure below summarises the interaction between all the different components of the Matrix.

Prof Bob Garratt, Tom Wixley, Prof Phillip Sutherland and Kwelele Gumbi participated in the core development team. Additional input was provided by Stephen Davis (Yale) and Paul Lee (Hermes EOS).
A MATRIX FOR STATE-OWNED ENTERPRISES

For the purpose of the Hanns Seidel Foundation (HSF) project the Matrix was adapted to increase its relevance for the SOE sector. This adaptation was undertaken by Lynn McGregor, project leader and senior research fellow at the Centre, and special advisor Nozizwe Madlala-Routledge, former Deputy Government Minister. Considerable research was done through interviews and conversations with senior officials of various government departments that are responsible for SOEs. To produce a relevant matrix it was important to understand how both government as a major shareholder and organisations worked and how they are interrelated. An important element of this is the way in which SOEs factor in Government mandates based on political policies. Given this information, the Matrix was modified considerably to reflect this relationship between SOEs and Government. It was also noted that at present the situation is highly complex given that each SOE has to take different legal acts into account. The SOE Matrix is in the early stages of development; it will need to be adjusted according to continuous feedback from all stakeholders and changing government requirements.

To ensure the optimal usefulness of the current matrix right from the start, a workshop was held in Cape Town on 25 October 2011. Representatives from public institutions were invited to discuss and refine the SOE Matrix. The following people attended the workshop:

- Ms Felicia Msiza, Broadband Infrastructure Company (Pty) Ltd
- Mr Johannes Maluleka, Broadband Infrastructure Company (Pty) Ltd
- Ms Fikile Mayisela, Independent Development Trust
- Ms Bianca Valentine, South African Human Rights Commission – Western Cape
- Mr Anthony Coombe, member of various Audit Committees
- Adv Boitshoko Senne, Armaments Corporation of South Africa Ltd (ARMSCOR)
- Adv Ruthven Janse van Rensburg, Office of the Public Protector (Western Cape)
- Dr Wolf Krug, Hanns Seidel Foundation
- Daniel Malan, Centre for Corporate Governance in Africa
- Anna Yortt, Centre for Corporate Governance in Africa
- Lynn McGregor, Centre for Corporate Governance in Africa
- Nozizwe Madlala-Routledge, independent consultant and project advisor
- Riedwaan Baboo, Centre for Corporate Governance in Africa.

Based on discussions at the workshop, input from the project team and subsequent input from workshop participants, the SOE Matrix was finalised for the purposes of the initial research project.

The SOE Matrix consists of 94 indicators divided into the following categories and sub-categories:

- Board and Committee Composition
  - Board Composition
  - Board Audit Committee
  - Other Board Committees
- Accountability
- Remuneration
- Functioning of the Board
  - Strategy
  - Sufficiency of Meetings and Evidence of Planning
  - Constructive Involvement of Government
- Reporting
  - Reporting and Quality of Reporting
  - Financial Reporting – Unqualified Audit Report
- Stakeholders
  - Stakeholder Relationships
  - Reputational Management
- Social
  - Evidence of Concrete Support for Governmental Priorities
- Environmental

The SOE Matrix will continue to evolve as it is not seen as a final product. However, the project team was satisfied that the end-product reflected all the material issues that had to be measured.
THE SOE MATRIX CATEGORIES AND INDICATORS

The detailed matrix components are presented below. This gives an indication of all the areas that were included in the assessments.

BOARD AND COMMITTEE COMPOSITION

BOARD COMPOSITION
1. Adequate mix of competencies, knowledge, experience and representation
2. Clear definition of director roles and responsibilities
3. Chairperson an independent non-executive (using the PIC definition)
4. Independent non-executive directors in majority (according to the PIC definition)
5. Company Secretary should not be a director of the company
6. Diversity (percentage of black and female directors)
7. Percentage of directors over-boarded (serving on too many boards)
8. Directors screened for integrity

BOARD AUDIT COMMITTEE
9. All members are independent or have independent majority and chairperson should be independent
10. Chairperson of the board is not a member of the Audit Committee
11. Collectively, members have adequate business, financial and leadership skills
12. Oversight of risk management if there is a Risk Management Committee
13. Audit Committee should be appointed at an AGM
14. Direct reporting line for internal auditor
15. Evidence of reports on control environment

OTHER BOARD COMMITTEES
16. Risk Management Committee – if not covered by the Audit Committee
17. Remuneration Committee
18. Nominations Committee
19. Social and Ethics Committee
20. Other working committees, e.g. Tender Committee, Investment Committee
21. To what extent does the board have oversight of the Executive Committee?

ACCOUNTABILITY
22. Compliance with relevant legislation, e.g. Public Finance Management Act (PFMA), Standing Committee on Public Accounts (SCOPA), Protocol on Corporate Governance, Companies Act, the Prevention and Combating of Corrupt Activities Act (PRECCA), Treasury Regulations, Promotion of Access to Information Act (PAIA) and other pertinent Acts to that particular Entity
23. Disclosure of CEO’s terms of contract and notice terms
24. Disclosure of CFO’s contract and notice terms (and any other executive directors)
25. Disclose extent of non-compliance with PFMA and other pertinent Acts
26. Disclose performance indicators (target and actual) per s55(2) of PFMA
27. Timeous submission of budget and corporate plan (s52)
28. Interim results and adequacy thereof
29. Timeous submission of annual report (s55)
30. Quarterly reporting to DPE (relevant ministry, or parliament)
31. Response to issues raised by DPE/ministry
32. Planned and comprehensive interface with parliamentary Portfolio Committee(s)
REMUNERATION
33. Average percentage increase in executive directors’ base salary
34. Average percentage increase in executive directors’ bonus
35. Clear remuneration policy/strategy
36. Prospective approval of remuneration
37. Existence of performance targets linked to the shareholder compact and remuneration policies
38. Existence of “golden parachutes or handshakes”

FUNCTIONING OF THE BOARD
39. Commitment to accountability, probity and disclosure (voluntary standards)
40. Existence of compliance and/or risk officer/function
41. Existence of board charter and committee charters
42. Annual review of charter of board and committees
43. Clarity and comprehensiveness of delegations of authority
44. Evidence of annual board and committee performance evaluation
45. Evidence of board and committee development programme
46. Appropriately qualified company secretary to service the board

STRATEGY
47. Evidence that Strategic Plan is discussed at board meetings
48. Evidence that Strategic Risk Register is discussed and agreed at board meetings
49. Balancing business needs and implementation of government priorities
50. Succession planning for directors and executive management
51. Competent, fair and effective nominations procedures
52. Suitable rotation of directors balanced with need for continuity

SUFFICIENCY OF MEETINGS AND EVIDENCE OF PLANNING
53. Ensure that agenda covers key items, including management/oversight of ethics, compliance, IT responsibility – as well as “normal” business matters such as CEO and CFO reports
54. Evidence that there is adequate debate and discussion at meetings
55. Appropriate documentation provided for directors in advance of meetings
56. Proper planning in evidence (year plan for meetings, documentation provided sufficiently in advance of meetings)
57. Regular and appropriate attendance of directors at scheduled board meetings
58. Regular and appropriate attendance of directors at scheduled board committee meetings

CONSTRUCTIVE INVOLVEMENT OF GOVERNMENT
59. Report on relationship with Government and, if relevant, other investors
60. Quality and appropriateness of working relationships with government
61. Involvement of Minister (preferably) and DG in annual preparation of corporate or strategic plan
62. Constructive, ongoing working relationships with DG or DDG
63. Constructive and appropriate involvement of shareholders
64. Relationships with other shareholders, if relevant

REPORTING

REPORTING AND QUALITY OF REPORTING
65. Quality and verification of Performance Information
66. Quality and verification of Management Reporting System
67. Quality of integrated reporting
68. Clear description of principle risks and uncertainties and how it will be managed
69. Disclosure of prosecutions, legal contraventions, judgements and fines
FINANCIAL REPORTING – UNQUALIFIED AUDIT REPORT
70. Existence of unmodified (no negative findings) audit report
71. Matters of emphasis included in audit report
72. Other negative findings included in audit report
73. Compliance with various statutory functions
74. Review of quality of finance function
75. Disclosure of concerns raised by the Auditor General and SCOPA
76. Report on remedial action taken
77. Follow up of irregularities (including any material irregularities reported in terms of s45 of Auditing Profession Act)
78. Review of quality of external audit
79. If external audit conducted by private sector auditors, prior clearance with Auditor–General (PFMA, s58(3))

STAKEHOLDERS

STAKEHOLDER RELATIONSHIPS
80. Evidence of stakeholder policy, strategy, analysis and engagement

REPUTATIONAL MANAGEMENT
81. Relationship with media
82. Relationship with customers

SOCIAL
83. Conformance to developmental regulatory mandates
84. Ability to respond to changing developmental priorities
85. Building and maintaining a culture of honesty and integrity
86. Codes of conduct and ethics

EVIDENCE OF CONCRETE SUPPORT FOR GOVERNMENTAL PRIORITIES
87. Specify CR policy and spend as percentage of profit after tax
88. Detail direction and demographics of spend
89. Specify impact on communities; local, national and international

ENVIRONMENTAL
90. Compliance with environmental requirements (both national and industry specific)
91. Evidence of environmental policy, strategy, monitoring and, where appropriate, a rehabilitation plan
92. Evidence of positive environmental audits
RESEARCH SAMPLE

It was agreed at the workshop that the research sample should include schedule 1 and 2 organisations as outlined in table 1 below.

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<thead>
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<table>
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<th>Schedule 2: Major public entities</th>
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<tbody>
<tr>
<td>1 Air Traffic and Navigation Services Company Ltd</td>
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<td>2 Airports Company of South Africa Ltd</td>
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<tr>
<td>3 Alexkor Ltd</td>
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<tr>
<td>4 Armaments Corporation of South Africa Ltd</td>
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<tr>
<td>5 Broadband Infrastructure Company (Pty) Ltd</td>
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<td>6 CEF (Pty) Ltd</td>
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<tr>
<td>7 DENEL (Pty) Ltd</td>
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<td>8 Development Bank of Southern Africa</td>
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<td>9 ESKOM</td>
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<td>10 Independent Development Trust</td>
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<td>11 Industrial Development Corporation of South Africa Ltd</td>
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<td>12 Land and Agricultural Development Bank of South Africa</td>
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<td>13 South African Airways (Pty) Ltd</td>
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<td>14 South African Broadcasting Corporation Ltd</td>
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<td>19 Telkom SA Ltd</td>
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<tr>
<td>20 Trans-Caledon Tunnel Authority</td>
</tr>
<tr>
<td>21 Transnet Ltd</td>
</tr>
</tbody>
</table>

TABLE 1: SCHEDULE 1 AND SCHEDULE 2 PUBLIC INSTITUTIONS AS AT 31 DECEMBER 2010
PROJECT TEAM

The project team comprised the following individuals:
• Lynn McGregor (project leader): Lynn is a senior research fellow at the Centre for Corporate Governance in Africa, an acknowledged corporate governance author and consultant;
• Anna Yortt (project manager): Anna is the research manager at the Centre for Corporate Governance in Africa;
• Daniel Malan (project advisor): Daniel is the director of the Centre for Corporate Governance in Africa and senior lecturer in Ethics and Governance at the University of Stellenbosch Business School;
• Nozizwe Madlala-Routledge (project advisor): Nozizwe is a former deputy government minister. She has extensive knowledge of government and parliament, and considerable chairmanship, facilitation and organisational experience; and
• Riedwaan Baboo (researcher).

RESEARCH PROCESS

The research was conducted in two stages:
• Public research: The Matrix was applied to Schedule 1 and Schedule 2 SOEs by research analysts based on publicly available information, including annual reports, sustainability reports and websites. The long-term intention with the exclusive focus on publicly available information is to encourage disclosure and transparency. Although the expectation was that disclosure levels would be much lower than in the private sector, for comparative purposes the decision was made to restrict the initial stage to publicly available information only; and
• Survey: An electronic survey was developed and sent to the chief executive officers of the 30 Schedule 1 and Schedule 2 SOEs with a two-week deadline. Phone call and email follow-up was undertaken in order to ensure the survey was received. An email reminder was also sent out and follow-up phone calls were made. The deadline was also extended by one week to improve the response rate.

Some of the indicators that are not applicable to Schedule 1 entities were removed from the analysis of these entities. As a result of the very low levels of disclosure in this category it was decided not to release the names of the Schedule 1 top performers, since these scores were all below 50%.

RESULTS

This section presents the headline results. Each entity was assessed based on the Matrix (some indicators were removed for Schedule 1 entities) and scored out of a possible maximum of 100%. Detailed scores of all entities will not be made available publicly since the intention of the research project was to assist SOEs to improve their governance performance and not to name and shame poor performers.

The top 5 Schedule 2 entities were:
1. DENEL (Pty) Ltd
2. Transnet Ltd
3. Telkom SA Ltd
4. South African Post Office Ltd
5. Development Bank of Southern Africa

INTERPRETATION OF RESULTS

A detailed interpretation of the results has been hampered by poor disclosure on many of the issues that were being assessed. In fact, some issues were not disclosed at all by any of the entities. However, as was mentioned in the earlier part of this report, this did not come as a surprise. Overall, it is our understanding that the findings of our research are not dissimilar to the results of the forthcoming Presidential Report on SOEs.

It should also be emphasised that the SOE Matrix covers a very broad range of governance components that were assessed based on public disclosure. The research did not cover negative media coverage on any individual aspect, and also does not provide assurance on the accuracy of information disclosed in public documents. Therefore, a high score according to the SOE Matrix should not be interpreted as an endorsement of all governance practices of a particular entity. In terms of the current methodology, it is possible for an entity to receive negative media coverage on a particular component (e.g. corruption) while at the same time obtaining a high score as a result of good disclosure against all indicators.
More specific observations are outlined below.

**BOARD AND COMMITTEE COMPOSITION**

- **Board Composition:** None of the public entities disclosed details of screening directors for integrity, for example, whether they have been involved in corruption in the past. This should be part of the appointment process and details should be provided in the annual report.
- **Diversity:** The majority of SOEs have good representation of both black and female directors.
- **Board Audit Committee:** The majority of organisations did not provide information on the appointment of the audit committee.
- **Other Board Committees:** The majority of organisations did not disclose details of a social and ethics committee.

**ACCOUNTABILITY**

- There was a lack of disclosure on submission of annual reports, budgets and corporate plans as well as responses to issues raised by the Department of Public Enterprises or the relevant Ministry. Interim results were only available for four organisations. Generally, issues relating to compliance with legislation were well reported and details were provided on instances of non-compliance.

**FUNCTIONING OF THE BOARD**

- **Sufficiency of Meetings and Evidence of Planning:** There was no disclosure on this issue. This is something we would like public entities to disclose in future as it provides stakeholders with an impression of the effectiveness of board meetings. Generally, board and committee attendance was not optimal with a few organisations having no directors who attended more than 75% of scheduled board and committee meetings.
- **Constructive Involvement of Government:** Disclosure on the working relationship with the Director-General or Deputy Director-General was very poor. Often, the working relationship with government was disclosed but it was difficult to determine the quality and appropriateness of this relationship. Reporting could be improved in this area.

**REPORTING**

- **Reporting and Quality of Reporting:** In terms of the quality and verification of performance information, it was often found that although performance information was presented it was not of an acceptable quality. This was often identified by the Auditor-General. This was particularly an issue for Schedule 1 entities. Approximately half of the Schedule 2 organisations and only one of the Schedule 1 organisations produced a good quality integrated report.
- **Financial Reporting – Unmodified Audit Report:** Two of the Schedule 1 organisations and three of the Schedule 2 organisations did not have an unmodified audit report.

**SCHEDULE 1 SOES**

Many of the institutions either do not have board members with adequate business management skills and expertise as well as financial and accounting knowledge to have effective oversight or this information was not provided. The board members are appointed either by parliament, the President or the relevant ministry based on their knowledge, experience and skills, and they are actively involved in executive decision making and implementation of operational plans to realise the institutions’ respective developmental objectives. Notwithstanding the fact that these institutions have considerable budgetary and human resources constraints relative to the scope of their mandates, more resources and capacity have to be allocated to governance to ensure the sustainability and integrity of the institution is not compromised.

In some instances there was no disclosure on how the commissioners are appointed or whether they are considered to be independent.

However, it was often clear that the commissioners are involved in the day-to-day operations of the organisation on a full-time or part-time basis, which impairs their independence. In two instances the chairman also acted as the executive authority of the organisation thereby impairing independence. In some cases it was also stated that commissioners are appointed
by the President or Parliament which would be considered a representative who is able to control or significantly influence management.

As these institutions do not have boards of directors, audit committee members are mainly external members (PWC, 2010). They are required to have the necessary knowledge and experience. However, no details were provided of these external members in order to make an assessment of their expertise. In most cases the method of appointment of the audit committee was not disclosed.

None of the Schedule 1 organisations provided any record of a company secretary or equivalent. In one instance a corporate secretary was in place but there was no detail on the role so it was unclear whether this person performed the function within this organisation. These responsibilities should be completed through delegated officials (PWC, 2010) and details of this should be provided in the report.

In some instances the remuneration of commissioners was not disclosed.

None of the Schedule 1 organisations reported any environmental information. The PFMA states that annual reports should include "information about the institution’s efficiency, economy and effectiveness in delivering programmes and achieving its objectives and outcomes" including elements of sustainability reporting (PWC, 2010). Therefore we would expect to see some environmental reporting although we appreciate that the impact will often be low.

There should also be more detailed disclosure on the relationship between the institution and portfolio committee(s) it reports to; various government departments and agencies as well as the relevant Minister, Director-General and Deputy Director-General. This will enable the readers of annual reports to obtain insight into the working relationship as well as issues and challenges confronting the institution and its capacity to realise its developmental objectives.

Finally, the quality and verification of the performance information and management reporting needs serious attention as stakeholders will be unable to hold the institution to account. Improved governance, appropriate business skills, sound planning and realistic and transparent objectives and performance indicators will enable the institution and external stakeholders to monitor and evaluate the conformance and performance of the institution.

**SCHEDULE 2 SOES**

Generally, Schedule 2 organisations were able to balance business needs with the implementation of government priorities.

Most board members do not meet the traditional definition of independence due to the nature of their appointment. This also had an impact on the levels of independence within the committees. In most cases the method of appointment of the audit committee was not provided.

Remuneration was generally well reported for Schedule 2 organisations.

Greater scrutiny and emphasis need to be placed on the CEO and executive committee and in this regard, disclosure on realisation of key performance indicators and substantive reporting on variances. In addition, information is required on how performance indicators are related to awarding of bonuses for executives. Furthermore, greater disclosure is also required on board performance evaluation and the adoption of best practice of external evaluation needs to be prioritised. Often the terms of appointment of the CEO are not disclosed.

Greater disclosure is required in terms of the working relationship with the relevant Ministry and its involvement in promoting ethical conduct and good governance practices. Equally important is the Ministry's involvement and contribution in drafting the organisation's strategic goals and objectives and the monitoring and reporting mechanisms that are in place to hold companies to account.

**SURVEY RESPONSE**

Unfortunately, the response rate was poor with only seven responses received from 30 invitations. Six of the responses were from Schedule 2 organisations and one was from a Schedule 1
organisation. One of the responses had to be excluded due to a discrepancy between the organisation name and the respondent. Given the low response rate statistical analysis is not appropriate. However, a brief overview is provided. We would like to thank the organisations who did take the time to respond.

**SCHEDULE 1**

When the survey response was used to supplement the public research there was an improvement in the overall score. This highlights the need for increased disclosure in the public report so that stakeholders are able to gain more comprehensive insight into the organisation. Particular areas where an improvement was noted were in sufficiency of meetings and evidence of planning as well as constructive involvement of government. It was also confirmed that external audit committee members do have the appropriate qualifications and experience. Also, the existence of a company secretary for this organisation was confirmed in the survey but not in the report.

**SCHEDULE 2**

Many of the issues that were lacking in the report were clarified by the survey response. To improve transparency we would encourage organisations to include these elements in future public reports. Specific issues that were commonly clarified by the survey response and that would improve performance in the public research include an appropriately qualified company secretary, the appointment of the audit committee, the link between remuneration and performance targets, sufficiency of meetings and evidence of planning and constructive involvement of government, screening directors for integrity, timeous submission of corporate plans and budgets. Organisations will improve their rankings by disclosing more information while also benefiting from their improved performance in these areas.

**COMPARISON WITH PRIVATE SECTOR**

As the Matrix was revised to ensure that it is applicable to the public sector the results are not directly comparable with private sector results. However, specific indicators are duplicated in both versions of the Matrix. The comparisons drawn here are for the 20 Schedule 2 major public entities as at 31 December 2010 and the JSE top 40 as at 30 November 2010.

A statistically significant difference was found for the independence of the chairperson and also the board comprising a majority of independent directors with the private sector performing better in both instances. This can be explained by the method of appointment in the public sector outlined earlier in the report. However, when diversity was assessed the public sector performed better in terms of both black and female board representation. For both board and committee attendance the private sector performed better. Again, for an unmodified audit report the private sector performed better with all of the top 40 having an unmodified audit report.

![Figure 2: Comparison Between Private Sector and State-Owned Enterprises for Common Indicators](image-url)

Rating Corporate Governance of State-Owned Enterprises
RECOMMENDATIONS

This research highlights the need to improve the governance structures, mechanisms and processes existing within public entities. However, there are areas of good performance and the entities that have received recognition in this report could be used by other SOEs as a benchmark. Our recommendations address performance issues as well as suggestions for a future research agenda.

In terms of performance, the overall recommendation is that all entities should improve their disclosure. In particular, more information is required on issues such as board committees, sufficiency of meetings and evidence of planning, as well as the position of the company secretary. Without disclosure it is impossible to measure performance accurately, and it is our hope that more detailed disclosure in future will allow shareholders and other stakeholders to perform a more accurate assessment of individual performance areas.

In terms of a future research agenda, we recommend the following:

- Apply and continue to modify the SOE Matrix as part of a joint USB, Hanns Seidel Foundation and (possibly) Government project: we believe that the SOE Matrix should be made available to all SOEs as a template that could be used to measure and report on governance performance. In this regard, we recommend further discussions to be held with members of the former Presidential Review Committee on State-Owned Enterprises and the Public Investment Corporation;
- Continue to rate SOEs and revise the Matrix on an annual basis;
- Expand the number of entities being rated;
- Conduct a survey to ascertain key interventions, training and coaching needed to accelerate the development of SOEs towards best practice;
- Provide Corporate Governance training and coaching for all SOE boards, Government Departments and Senior Executives; and
- Set up a formal research and development unit for the assessment and development of governance in SOEs.

As the Centre for Corporate Governance in Africa, we would like to begin to create a broader body of knowledge in this area. We would like to thank the Hanns Seidel Foundation for its support, and all the entities and individuals that supported the various aspects of our project. We regard the development of the SOE Matrix as the most important contribution of this project. As mentioned before, we believe this is only the start of much more comprehensive research in this area, and we look forward to cooperating with all stakeholders in future.

REFERENCES

Chabane, C. 2010. Statement by Minister Collins Chabane on the terms of reference and review framework and methodology of the Presidential State Owned Enterprises (SOE) Review Committee Imbizo Media Centre, 120 Plein Street, Cape Town, 12 October 2010
